

## **CHAPTER 81-03-05.2 WATER'S EDGE METHOD**

### **Section**

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### **81-03-05.2-01. Definitions.**

As used in these sections and for the administration of North Dakota Century Code chapter 57-38.4, unless the context otherwise requires:

1. "Assets" means both tangible and intangible property valued at original cost less depreciation, amortization, or depletion as reflected on the corporation's balance sheet prepared according to generally accepted accounting principles.
2. "Average of property and payroll" means average of property and payroll as defined pursuant to chapter 81-03-09 and North Dakota Century Code chapters 57-38.1 and 57-59.
3. "Commissioner" means the tax commissioner of the state of North Dakota.
4. "80/20 corporation" means a corporation that:
  - a. Is incorporated in the United States.
  - b. Is eligible to be included in a federal consolidated return as defined in subsection 5 of North Dakota Century Code section 57-38.4-01.
  - c. Has eighty percent or more of the average of its property and payroll assigned to locations in foreign countries.
5. "Foreign corporation" means a corporation incorporated outside the United States.
6. "Foreign country" means a country other than the United States or a possession of the United States.
7. "Income from an 80/20 corporation" means net book income for financial statement purposes. However, a corporation's net book income cannot be offset by a net book loss from another 80/20 corporation.
8. "Net book income for financial statement purposes" as used herein means the results of operations as determined using the accrual method of accounting and generally accepted accounting principles as adopted by the American institute of certified public accountants. If a corporation has more than one financial statement, it must use the first statement in the following priority:
  - a. Financial statements required to be filed with the securities and exchange commission.
  - b. Financial statements audited by an independent certified public accountant.

- c. Income statements prepared for a nontax purpose required to be provided to the federal government, state government, or a political subdivision of state government.
  - d. Income statements prepared for credit purposes, for reporting to stockholders or other owners, or for any other nontax purpose. An unaudited report that is accompanied by an independent auditor's review report has priority over another unaudited statement.
- 9. "New corporation" means a corporation that either has not filed or was not required to file an income tax return after the 1979 tax year.
  - 10. "Property, payroll, and sales" means property, payroll, and sales as defined in chapter 81-03-09 and North Dakota Century Code chapters 57-38.1 and 57-59.
  - 11. "State" means each of the fifty states and the District of Columbia.
  - 12. "Taxpayer" means a corporation that is required to file an income tax return in North Dakota.
  - 13. "Transaction" means an event that causes a change in a corporation's assets, liabilities, or owner's equity.
  - 14. "United States" means the fifty states and the District of Columbia.

**History:** Effective July 1, 1989; amended effective March 1, 1990; April 1, 1995; July 1, 1998.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.4

#### **81-03-05.2-02. Water's edge election.**

A taxpayer may elect to use the water's edge method for any taxable year beginning on or after January 1, 1989.

- 2. A water's edge election is made when each taxpayer in the unitary group checks the water's edge box on its original North Dakota income tax return for the first year to which the election applies.
- 3. If a water's edge taxpayer files a consolidated water's edge return, the election made on that return shall apply to all members of the water's edge group included in that return.
- 4. An affiliated corporation is considered to have consented to a water's edge election if the corporation becomes a member of the group after the group elects to use the water's edge method.

**History:** Effective July 1, 1989; amended effective August 1, 1994; April 1, 1995.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.4-02

#### **81-03-05.2-03. Method of reporting.**

A water's edge group shall use a combined report to determine the amount of income which should be assigned to North Dakota on behalf of each member of the group. If the combined report assigns income to North Dakota on behalf of a member of the group, that member shall report the assigned income on its North Dakota income tax return.

**History:** Effective July 1, 1989.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.4-02

#### **81-03-05.2-04. Elements of the water's edge combined report.**

1. A taxpayer who elects to use the water's edge method shall include the income and the apportionment factors of the water's edge group in its combined report. The aforementioned group must include the following corporations:
  - a. A United States parent corporation.
  - b. An affiliated corporation incorporated in the United States, excluding, however, an 80/20 corporation.
  - c. An affiliated corporation incorporated in a possession of the United States as described in Internal Revenue Code sections 931 through 936.
  - d. A domestic international sales corporation as described in Internal Revenue Code sections 991 through 994.
  - e. A foreign sales corporation as described in Internal Revenue Code sections 921 through 927.
  - f. An export trade corporation as described in Internal Revenue Code sections 970 through 972.
  - g. A foreign corporation which derived gain or loss from disposing of a United States real property interest but only to the extent the gain or loss was recognized under Internal Revenue Code section 897.
  - h. A foreign corporation if over fifty percent of its voting stock is owned, directly or indirectly, by a member of the water's edge group, and if more than twenty percent of the average of its property and payroll is assignable to a location within the United States or its possessions.
2. Income for the water's edge group must be computed on the same basis as federal taxable income, except as provided for in the following subdivisions and in subsection 2 of North Dakota Century Code section 57-38.4-02, and plus or minus the adjustments provided for in North Dakota Century Code section 57-38-01.3 with the exception of subdivision c of subsection 1 of North Dakota Century Code section 57-38-01.3:
  - a. Transactions between members of the water's edge group must be eliminated.
  - b. Transactions between a member of the water's edge group and an affiliated corporation that has been excluded from the group must be included.
  - c. If a corporation is included in the water's edge group but it is not required to file a federal income tax return, the equivalent of its federal taxable income must not include a deduction for foreign taxes based on income.
  - d. For the purpose of computing federal taxable income, a foreign sales corporation must include the foreign trade income which is exempt from federal income tax under the Internal Revenue Code.
3. The factors used to apportion the income of the water's edge group must be determined pursuant to North Dakota Century Code chapters 57-38.1 and 57-59, chapter 81-03-09, and the following subdivisions:
  - a. Transactions between members of the water's edge group must be eliminated.

- b. Transactions between any member of the water's edge group and an affiliated corporation that has been excluded from the group must be included.
- c. The property, payroll, and sales of an 80/20 corporation, a dividend payor corporation, or any other affiliated corporation that has been excluded from the water's edge group must not be included in the apportionment factors of the group.

**History:** Effective July 1, 1989; amended effective August 1, 1994; July 1, 1998.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38-01.3, 57-38.1, 57-38.4, 57-59

**81-03-05.2-05. Domestic disclosure spreadsheet.**

1. A taxpayer electing to use the water's edge method shall file a domestic disclosure spreadsheet if the affiliated corporations as a group have:
  - a. Property, payroll, or sales in foreign countries exceeding ten million dollars.
  - b. Assets exceeding two hundred fifty million dollars.
2. The domestic disclosure spreadsheet must be filed the first year the conditions set forth in subsection 1 of section 81-03-05.2-05 are met and every third year thereafter provided the conditions set forth in subsection 1 of section 81-03-05.2-05 continue to be met.
3. A domestic disclosure spreadsheet must include the following:
  - a. A list of the corporations in the water's edge group and any corporation in which more than twenty percent of the voting stock is, either directly or indirectly, owned or controlled by a member of the water's edge group.
  - b. The following identifying information for each corporation listed in subdivision a:
    - (1) Federal identification number.
    - (2) Address.
    - (3) Percentage of voting stock, that is either directly or indirectly owned or controlled by each member of the water's edge group.
  - c. The following information for each corporation in the water's edge group:
    - (1) Primary business locations.
    - (2) Primary business activities.
    - (3) Country of incorporation.
    - (4) Dates of acquisition or disposition of the ownership interest.
    - (5) For each state which assesses a tax on, according to, or measured by net income, a schedule detailing the tax liability and the computations used to allocate or apportion the corporation's income to each state in which the corporation is taxable. The details which must be disclosed on the aforementioned schedule include:
      - (a) Whether the liability was computed on a single entity basis or pursuant to a combined report.
      - (b) The entities included in the combined report.

- (c) The federal taxable income for each entity whose income was included in determining the amount of income that was allocated and apportioned to the state.
  - (d) The amount of income apportioned to the state, the formula used to apportion the income, and the amount of property, payroll, and sales included in the formula used to apportion the income.
  - (e) The amount of income allocated to the state.
  - (f) The total amount of income not subject to apportionment by formula under the rules of the state.
  - (g) The amount of tangible personal property sales made or delivered to customers within the state.
- (6) For each state which does not assess a tax on, according to, or measured by income, a schedule disclosing the following information for each corporation which has a taxable presence in the state:
  - (a) The federal taxable income for the corporation or for the federal consolidated filing group of which the corporation is a member.
  - (b) The amount of property, payroll, and sales that would be assigned to the state under North Dakota Century Code chapter 57-38.1 and the rules adopted pursuant thereto.
  - (c) The amount of tangible personal property sales made or delivered to customers within the state.
- d. A copy of pages one through four of the federal income tax return that was filed with the internal revenue service for each corporation listed in subdivision c.
- 4. The spreadsheet information must be filed on the forms provided by the commissioner. Data not submitted on the preapproved forms will be deemed incomplete.
- 5. If the information required to be reported on the spreadsheet is not available when the return is filed, a taxpayer may file the spreadsheet within six months after the due date of the return, including any extensions. If the aforementioned time deadlines cannot be met, a taxpayer shall file a written request for an extension of time with the commissioner within six months after the due date of the return, including any extensions. This request which will be deemed filed on the date it is sent by certified mail must state the grounds for the request. Within a reasonable time after receiving the request, the commissioner shall notify the taxpayer as to whether the request for additional time is granted. However, the commissioner will not grant an extension of time that exceeds one hundred twenty days.
- 6. A spreadsheet will be deemed complete when filed unless the commissioner notifies the taxpayer, within one hundred eighty days after the spreadsheet was filed, that the spreadsheet requirements have not been met. This notice must be sent by certified mail and it must inform the taxpayer as to why the spreadsheet was not properly completed. A taxpayer shall correct the deficiencies in its spreadsheet within ninety days after receiving the aforementioned notice of deficiency. If the ninety-day deadline cannot be met, a taxpayer shall file a written request for an extension of time with the commissioner within ninety days after receiving the notice of deficiency. This request which will be deemed filed on the date it is sent by certified mail must state the grounds for the request. Within a reasonable time after receiving the request, the commissioner shall notify the taxpayer as to whether the request for additional time is granted.

**History:** Effective July 1, 1989; amended effective March 1, 1990; May 1, 1991; August 1, 1994.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.4-02

**81-03-05.2-06. Failure to comply with water's edge election.**

1. If a taxpayer fails to make a valid water's edge election, the taxpayer will be prohibited from using this method to apportion its income for the year in question. If this occurs, the taxpayer shall determine its income and resulting tax liability pursuant to North Dakota Century Code chapters 57-38, 57-38.1, and 57-59, which chapters include reporting on a worldwide combined basis.
2. A taxpayer's failure to file a spreadsheet or to correct deficiencies in its spreadsheet will constitute a failure to file a return. If this occurs, the tax liability computed under the water's edge method will be subject to penalty and interest pursuant to North Dakota Century Code section 57-38-45.
3. If a taxpayer fails to comply with the conditions in North Dakota Century Code section 57-38.4-02 and this chapter, the commissioner may rescind the taxpayer's water's edge election for the entire election period. If this occurs, the commissioner will require the taxpayer to apportion its income for the period to which the election applied pursuant to worldwide combination or any other method of reporting permitted under North Dakota Century Code chapter 57-38, 57-38.1, or 57-59.

**History:** Effective July 1, 1989.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-38.4, 57-38-45

**81-03-05.2-06.1. Recission of a water's edge election.**

1. The water's edge election of a corporation that has had more than fifty percent of its voting stock acquired by a nonaffiliated corporation is rescinded.
2. The water's edge election of a corporation formed due to a reorganization or spinoff from an existing taxpayer is rescinded if, after such reorganization or spinoff, it is no longer an affiliated member of the water's edge group.
3. The water's edge election of a corporation that is completely liquidated is rescinded. The election does not carry over to a corporation receiving the liquidated assets. This provision does not affect the water's edge election made by any corporation that receives liquidated assets.

**History:** Effective April 1, 1995.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-38.4

**81-03-05.2-07. Procedure for review of tax commissioner's rescision of water's edge election.**

1. The commissioner shall notify a taxpayer if there is a decision to rescind the taxpayer's water's edge election. The notice of rescision must be sent to the taxpayer by certified mail with a return receipt requested, and it must state the reasons for the rescision.
2. The notice of rescision becomes final and irrevocable thirty days after the date the notice is received by the taxpayer unless within that thirty-day period the taxpayer files a written protest with the commissioner. The protest which will be deemed filed on the date it is sent by certified mail must state the grounds upon which the protest is based.

3. If a protest is filed, the commissioner shall reconsider the notice of recision. This reconsideration may include further examination by the commissioner of any affiliated corporation's books, papers, records, or memoranda pursuant to North Dakota Century Code sections 57-01-02, 57-38-56, and section 81-01.1-01-03.
4. Upon request, the commissioner may grant the taxpayer an informal conference.
5. Within a reasonable time after receiving the protest, the commissioner shall notify the taxpayer as to whether the decision to rescind the taxpayer's water's edge election is affirmed or reversed. Notice of this reconsideration must be sent to the taxpayer by certified mail with a return receipt requested. A decision to affirm becomes final and irrevocable thirty days after the notice of reconsideration has been received by the taxpayer unless, within that thirty-day period, the taxpayer seeks formal administrative review by filing a complaint and requesting an administrative hearing. The provisions of North Dakota Century Code chapter 28-32 will apply to and govern the filing of the complaint and the administrative hearing, including an appeal of the decision rendered by the commissioner.
6. Upon written request, the commissioner may grant an extension of time to file a protest or a complaint.

**History:** Effective July 1, 1989.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-01-02, 57-38-56, 57-38.4

**81-03-05.2-08. Administrative provisions of income tax law applicable.**

Administration of the water's edge method under North Dakota Century Code chapter 57-38.4 will be governed by those provisions in North Dakota Century Code chapters 57-38, 57-38.1, and 57-59 which are not in conflict with any provision in North Dakota Century Code chapter 57-38.4.

**History:** Effective July 1, 1989.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-38.4, 57-59